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LIMDIS/GREENBACK FOR TREASURY UNDER SECT. BENNETT

FOL REPEAT OF BRUSSELS 9897 DEC 14 TO SECSTATE TREASURY OECD PARIS

QTE:

C O N F I D E N T I A L BRUSSELS 9897

LIMDIS GREENBACK

FOR TOM ENDERS AND COOPER, DEPT. OF TREASURY

DEPT OF TREASURY FOR COOPER

E.O. 11652: GDS

TAGS: EFIN, G-10, OECD, BE

SUBJECT: PROGRESS REPORT BY THE CHAIRMAN OF THE WORKING GROUP
ON TECHNICAL STUDIES FOR STRENGTHENING FINANCIAL AND MONETARY
COOPERATION AMONG OECD COUNTRIES.

FOLLOWING IS TEXT DELIVERED BY JACQUES VAN YPERSELE TO
EMBASSY BRUSSELS OF PROGRESS REPORT BY THE CHAIRMAN OF THE
WORKING GROUP ON TECHNICAL STUDIES FOR STRENGTHENING
FINANCIAL AND MONETARY COOPERATION AMONG OECD COUNTRIES.
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1. BEGIN TEXT. QUOTE: THIS PROGRESS REPORT TRIES TO SUMMARISE THE VIEWS EXPRESSED AT THE FIRST MEETING OF THE GROUP ON THE QUESTIONS RAISED IN X/DEP/WG REC/2 AND PROVIDE A BASIS FOR WORK DURING THE NEXT MEETING. A DISTINCTION IS MADE BETWEEN WHAT APPEAR TO BE THE MAIN UNRESOLVED QUESTIONS (PART I) AND OTHER QUESTIONS (PART II). THE MAJOR UNRESOLVED QUESTION IS CLEARLY THE RESPECTIVE MERITS OF A LOAN OR GUARANTEE SCHEME AND THE POSSIBLE CHARACTERISTICS OF A MIXED SCHEME. IT WAS RECOGNIZED, HOWEVER, THAT THIS QUESTION IS CLOSELY INTERRELATED WITH A CERTAIN NUMBER OF OTHER QUESTIONS, SUCH AS OPTING OUT, CONTINGENT LIABILITIES UNDER GUARANTEE ARRANGEMENTS, INTEREST RATES AND CURRENCY DENOMINATION, BORROWING LIMITS, ETC..., WHICH ARE THEREFORE ALSO DISCUSSED IN PART I. DECISION ON THE QUESTIONS DISCUSSED IN PART II, ON THE OTHER HAND, WOULD APPEAR TO BE RELATIVELY LITTLE AFFECTED BY THE CHOICE MADE WITH REGARD TO THE BASIC MECHANISM. AN ANNEX SUGGESTS POSSIBLE DRAFTING FOR SOME OF THE QUESTIONS DISCUSSED IN PART II.

2. IT SHOULD BE NOTED THAT WHERE IN WHAT FOLLOWS, REFERENCE IS MADE TO VARIOUS DEGREES OF AGREEMENT ON SPECIFIC QUESTIONS, THIS IS SUBJECT TO CERTAIN GENERAL QUALIFICATIONS. FIRST, ALL MEMBERS OF THE GROUP HAVE SO FAR ONLY BEEN GIVING THEIR PRELIMINARY REACTIONS, IT BEING UNDERSTOOD THAT AN AGREEMENT ON ANY PARTICULAR POINT IS SUBJECT TO THE NATURE OF THE FINAL PACKAGE. SECOND, SEVERAL MEMBERS HAVE INDICATED THAT THEIR COUNTRIES' POSITION ON THE NEED FOR, AND NATURE AND SIZE OF, ANY SCHEME ALONG THE LINES DISCUSSED HERE DEPENDS ON DECISIONS TAKEN CONCERNING OTHER RECYCLING ARRANGEMENTS, IN PARTICULAR, THE 1975 OIL FACILITY IN THE IMF.

3. AT THE BEGINNING OF THE NEXT MEETING ON DEC. 20 AN ILLUSTRATIVE OUTLINE WILL BE DISTRIBUTED BY THE CHAIRMAN TO THE MEMBERS OF THE GROUP.

PART I -- THE MAIN UNRESOLVED QUESTIONS

1. ADVANTAGES AND DISADVANTAGES OF ALTERNATIVE
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MECHANISMS

4. VARIOUS ARGUMENTS WERE PUT FORWARD IN FAVOUR OF A SCHEME IN WHICH EACH PARTICIPANT WOULD NORMALLY BE EXPECTED TO MAKE A DIRECT CONTRIBUTION TO EACH LOAN IN PROPORTION TO ITS QUOTA (EXCLUDING THE QUOTA OF THE BORROWING COUNTRY). IT WAS SUGGESTED THAT A MECHANISM OF THIS KIND, WHICH WOULD NOT INVOLVE RECOURSE TO

PRIVATE MARKETS, WOULD BE BOTH MORE CREDIBLE AND MORE SUITABLE FOR A SYSTEM OF FINANCIAL SOLIDARITY. IT WOULD BE MORE SIMPLE TO OPERATE, PARTICULARLY WITH REGARD TO DECISIONS CONCERNING INTEREST RATES AND THE SHARING OF EXCHANGE RISKS. IT WOULD ALSO AVOID VARIOUS WELL KNOWN DISADVANTAGES WITH A GUARANTEE SYSTEM DISCUSSED BELOW.

5. MANY MEMBERS OF THE GROUP FELT THAT THE MAJOR DISADVANTAGE OF A MECHANISM BASED ON DIRECT CONTRIBUTIONS IS THAT IT WOULD OBLIGE ALL COUNTRIES TO DRAW ON THEIR RESERVES AT A TIME WHEN SOME OF THEM, WHILE NOT ACTUALLY IN NEED OF A LOAN, WERE ONLY JUST MANAGING TO ATTRACT THE FUNDS NECESSARY TO KEEP THEIR EXTERNAL ACCOUNT IN BALANCE. SUCH COUNTRIES MIGHT FIND THEMSELVES PUSHED INTO THE POSITION OF HAVING TO REQUEST A LOAN FROM THE SCHEME; IF GRANTED, THESE LOANS MIGHT CREATE SIMILAR DIFFICULTIES FOR OTHER CONTRIBUTING COUNTRIES PROVOKING FURTHER REQUESTS FOR FULL LOANS, THUS LEADING TO A FAR GREATER USE OF THE SCHEME THAN WOULD BE COMPATIBLE WITH THE AIM OF MAKING IT A LAST-RESORT SAFETY NET. IT MORE GENERAL TERMS, IT WAS SUGGESTED THAT THIS MECHANISM WOULD BE CUMBERSOME IN CONDITIONS IN WHICH THE NEED WAS TO RECYCLE FUNDS FROM ONE OR A FEW COUNTRIES IN A STRONG EXTERNAL POSITION TO ONE OR MORE COUNTRIES IN NEED OF FINANCIAL ASSISTANCE.

6. THE MAIN ADVANTAGE SEEN FOR A MECHANISM BASED ON BORROWING FROM THE MARKET BACKED BY MULTILATERAL GUARANTEES IS THAT IT WOULD AVOID THE DIFFICULTIES JUST DISCUSSED. IT HAS ALSO BEEN SUGGESTED THAT SINCE THE FUNDS IN QUESTION ARE LIKELY TO BE FOUND SOMEWHERE IN THE MONEY OR CAPITAL MARKETS OF THE

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PARTICIPATING COUNTRIES, SUCH A MECHANISM WOULD BE BOTH LOGICAL AND FLEXIBLE. IN SOME COUNTRIES IT MIGHT ALSO BE EASIER TO OBTAIN THE NECESSARY LEGISLATIVE APPROVAL FOR THIS TYPE OF SCHEME.

7. MANY MEMBERS OF THE GROUP RECOGNIZED THAT A MULTILATERAL GUARANTEE SCHEME ALSO HAS VARIOUS DISADVANTAGES. FOR THE GUARANTEE TO BE EFFECTIVE, EACH PARTICIPANT'S CONTINGENT LIABILITIES HAVE SUBSTANTIALLY TO EXCEED ITS QUOTA SHARE IN THE LOAN, PARTICULARLY IF THE GUARANTEE HAS TO COVER BOTH PRINCIPAL AND INTEREST. THE INTEREST RATE THAT HAS TO BE PAID MAY BE HIGHER THAN WOULD BE IN THE CASE IF SOME COUNTRIES BORROWED IN THEIR OWN NAME. MORE GENERALLY, IT WAS SUGGESTED THAT WITH A GUARANTEE SYSTEM THERE MIGHT BE A SENSE IN

WHICH THE PARTICIPANTS FELT THEY WERE GETTING SOMETHING FOR NOTHING AND THEREFORE THE SCHEME WAS NOT ADMINISTERED WITH THE NECESSARY DEGREE OF DISCIPLINE.

8. IN THE LIGHT OF THE GROUP'S DISCUSSION OF THE RESPECTIVE MERITS OF THESE MECHANISMS, THE CHAIRMAN SUGGESTS THAT SOME FURTHER WORK SHOULD CONCENTRATE ON THE FEASIBILITY OF SOME FORM OF "MIXED" SYSTEM. IT MAY BE NOTED THAT THE SUGGESTIONS MADE BY THE U.S. MEMBER ENVISAGED AN OPTION WHEREBY A PARTICIPANT COULD PROVIDE RESOURCES BY ALLOWING THE SOLIDARITY FUND TO BORROW FROM THE PRIVATE MARKET ON THE BASIS OF A BILATERAL OR MULTILATERAL GUARANTEE. ADVOCATES OF A GUARANTEE MECHANISM, ON THE OTHER HAND, WOULD PRESUMABLY AGREE THAT PARTICIPANTS SHOULD BE ALLOWED TO MAKE DIRECT CONTRIBUTIONS IF THEY SO WISH. THE CHOICE OF A MIXED SYSTEM CAN ALSO BE JUSTIFIED ON THE GROUNDS THAT IT CAN BE MORE EASILY ADAPTED TO COPE WITH DIFFERING CIRCUMSTANCES. IT WAS SUGGESTED THAT THERE ARE ESSENTIALLY TWO POSSIBLE TYPES OF RECYCLING SITUATIONS: FIRST, THE CASE WHERE THE OIL MONEY IS SPREAD FAIRLY EVENLY, WITH THE EXCEPTION OF ONE OR TWO COUNTRIES WHICH ARE IN DIFFICULTY BECAUSE THEY CANNOT ATTRACT OR BORROW SUFFICIENT FUNDS; SECOND, THE OIL MONEY IS TENDING TO FLOW MAINLY INTO ONE OR TWO COUNTRIES WHICH HAVE EXCESS FUNDS, WHILE SOME OTHERS ARE IN DIFFICULTY. IN
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THE FIRST CASE, IT WOULD BE APPROPRIATE TO CALL ON ALL PARTICIPANTS (EXCEPT THE COUNTRIES WHICH NEED SUPPORT) TO FINANCE THE LENDING - AND THIS IS THE EFFECT OF CALLING UP DIRECT LOANS FROM ALL PARTICIPANTS (EXCEPT THE BORROWERS) IN PROPORTION TO THEIR QUOTAS AND WITH LITTLE POSSIBILITY OF OPTING OUT. IN THE SECOND CASE, HOWEVER, SUCH A METHOD OF FINANCING IS INAPPROPRIATE BECAUSE IT DOES NOT REDISTRIBUTE THE OIL FUNDS IN THE DESIRED WAY; IT WOULD BE BETTER IN THIS CASE TO OBTAIN FUNDS FROM THE COUNTRIES WHICH HAVE A SURPLUS BY BORROWING IN THEIR CAPITAL MARKETS AGAINST GUARANTEES PROVIDED BY SOME OR ALL PARTICIPANTS.

2. ROLE OF THE B.I.S. IN A MIXED SYSTEM

9. THE GROUP NOTED THE RELUCTANCE OF THE B.I.S. TO BE INVOLVED AS A PRINCIPAL WITH REGARDS TO LOANS TO PARTICIPANTS. THIS VIEW WAS SHARED BY SEVERAL MEMBERS OF THE GROUP.

10. ON THE OTHER HAND, THE GROUP NOTED WITH INTEREST THE POSSIBILITY THAT THE B.I.S. MIGHT BE ABLE TO HELP

PARTICIPANTS IN THE SCHEME TO TAKE PART IN A LENDING OPERATION BY PRE-FINANCING OR FINANCING THEIR CONTRIBUTIONS. THIS POSSIBILITY HAS BEEN DISCUSSED FURTHER SINCE THE FIRST MEETING. IT IS UNDERSTOOD THAT THE ARRANGEMENTS MIGHT WORK ALONG THE FOLLOWING LINES:

(A) THE B.I.S. WOULD MAKE CONVERTIBLE CURRENCIES AVAILABLE TO THE CENTRAL BANKS OF COUNTRIES PARTICIPATING IN A LENDING OPERATION IN THE FORM OF RENEWABLE DEPOSITS.

(B) IT WOULD BE UNDERSTOOD THAT THESE DEPOSITS COULD BE RENEWED FOR THE DURATION OF THE LENDING OPERATION IF THIS PROVED NECESSARY.

(C) UP TO A CERTAIN POINT, THE B.I.S. COULD PROVIDE THIS ASSURANCE ON THE BASIS OF ITS EXISTING RESOURCES. BUT BEYOND THIS POINT, THE B.I.S. WOULD NEED TO OBTAIN A LINE OF CREDIT FROM THE CENTRAL BANK CONCERNED TO PROTECT ITS LIQUIDITY POSITION. IN A NUMBER OF COUNTRIES,
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THE CENTRAL BANK WOULD IN TURN REQUIRE A GUARANTEE FROM ITS OWN GOVERNMENT.

(D) UNDER PRESENT MARKET CONDITIONS, THE MATURITY OF THE DEPOSITS MIGHT HAVE TO BE 3 OR 6 MONTHS RENEWABLE. BUT AS AND WHEN THE B.I.S. WERE ABLE TO OBTAIN LONGER TERM FUNDS THE MATURITIES COULD BE EXTENDED.

11. IF IT WERE AGREED THAT ARRANGEMENTS OF THIS KIND SHOULD FORM PART OF THE SCHEME, IT WOULD BE DESIRABLE TO HAVE A DECLARATION OF INTENT BY THE B.I.S. LINKED TO THE SETTING UP OF THE NEW FACILITY, INDICATING ITS WILLINGNESS TO ASSIST CENTRAL BANKS OF PARTICIPATING COUNTRIES TO FINANCE THE CONTRIBUTION OF THEIR GOVERNMENTS ON MARKET TERMS WITHIN THE FRAMEWORK OF ITS OWN STATUTES. IT WOULD ALSO BE DESIRABLE TO WORK OUT THE NECESSARY ARRANGEMENTS FOR BACKING UP CREDIT LINES IN ADVANCE.

12. IN ADDITION TO THE ABOVE, THE B.I.S. COULD ALSO ACT AS THE FINANCIAL AGENT OF THE FACILITY. ALSO, IF THE FACILITY WAS EMPOWERED TO BORROW FROM THE MARKETS ON THE BASIS OF PARTICIPANT'S GUARANTEES, THIS COULD BE ARRANGED THROUGH THE B.I.S., ALTHOUGH IT MIGHT BE BETTER TO USE OTHER FINANCIAL INSTITUTIONS WITH MORE EXPERIENCE IN THIS RESPECT.

13. THE B.I.S. OBSERVER OF OUR GROUP WILL BE CIRCULATING A PAPER ON THESE ISSUES TO ALL MEMBERS OF

THE GROUP BEFORE THE NEXT MEETING.

3. ALTERNATIVE POSSIBILITIES FOR A MIXED SYSTEM

14. DURING THE COURSE OF THE GROUP'S DISCUSSION OF POSSIBLE MIXED SYSTEMS, A NEAR CONSENSUS SEEMED TO EMERGE ON ONE IMPORTANT POINT: THAT, HOWEVER CONTRIBUTIONS ARE FINANCED, ALL PARTICIPANTS SHOULD SHARE IN THE ULTIMATE CREDIT RISK IN THE EVENT OF DEFAULT, IN PROPORTION OF THEIR SHARES IN THE QUOTAS.

15. WITHIN THIS FRAMEWORK, IT SEEMS POSSIBLE TO
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DISTINGUISH THREE MAIN TYPES OF MIXED SCHEMES.

A. DIRECT CONTRIBUTIONS AND/OR CONTRIBUTIONS
PREFINANCED BY THE B.I.S.

16 A SCHEME ALONG THESE LINES WOULD NOT INVOLVE ANY ADDITIONAL MULTILATERAL GUARANTEES, SINCE THE CONTRIBUTIONS PRE-FINANCED BY THE B.I.S. WOULD EFFECTIVELY BE BACKED BY THE BILATERAL GUARANTEE OF THE COUNTRY CONCERNED. PRESUMABLY THE CHOICE BETWEEN MAKING CONTRIBUTION DIRECTLY OR VIA THE B.I.S. WOULD BE LEFT TO EACH PARTICIPANT TO DECIDE. IF MOST COUNTRIES DECIDED TO GO THROUGH THE B.I.S. A QUESTION WOULD ARISE AS TO HOW MUCH MONEY THE B.I.S. WOULD FEEL ABLE TO MAKE AVAILABLE IN THIS WAY. TAKING THE FIGURES SUGGESTED IN THE U.S. NOTE, AND ASSUMING THAT THE U.S. QUOTA OF \$6.5 BILLION WAS ALWAYS PROVIDED IN THE FORM OF A DIRECT CONTRIBUTION, POTENTIAL CALLS ON THE B.I.S. COULD AMOUNT TO \$6 - 7 BILLION IF THE FACILITY WERE TO EXTEND LOANS TO THE UPPER LIMIT OF \$12.5 BILLION IMPLICIT IN THE U.S. PROPOSALS, (WITH BORROWING LIMITS SET EQUAL TO LENDING LIMITS.).

B. DIRECT CONTRIBUTIONS AND/OR CONTRIBUTIONS
PREFINANCED BY THE B.I.S. AND/OR BORROWING BY THE
FACILITY BACKED BY THE GUARANTEE OF ONE OR SOME
PARTICIPANTS

17. SOME MEMBERS OF THE GROUP SEEMED TO FEEL THAT A MIXED SYSTEM ALONG THESE LINES, IN WHICH SOME PARTICIPANTS COULD ASK THE FACILITY TO BORROW ON THEIR BEHALF, EITHER INDIVIDUALLY OR JOINTLY, COULD BE WORKABLE. OTHER MEMBERS WERE DUBIOUS SINCE IT IS LIKELY THAT IT WOULD BE THE WEAKER COUNTRIES WHICH WOULD WANT TO RAISE THEIR CONTRIBUTIONS IN THIS WAY, AND IT MIGHT WELL BE DIFFICULT FOR THE FACILITY TO BORROW ON REASONABLE TERMS WITH THE BACKING OF A GUARANTEE FROM ONLY THESE COUNTRIES.

18. WITH A SCHEME OF THIS KIND THERE WOULD BE A QUESTION AS TO WHETHER THE GUARANTEE AGREEMENT WOULD BE WORKED OUT ON AN AD HOC BASIS EACH TIME THE NEED AROSE, OR WHETHER ARRANGEMENTS WOULD BE BUILT INTO CONFIDENTIAL

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THE AGREEMENT ITSELF WHEREBY WHEN A COUNTRY EXERCISED THIS OPTION THIS AUTOMATICALLY BROUGHT INTO EFFECT GUARANTEE ARRANGEMENTS SHARED BETWEEN IT AND ALL THE OTHER PARTICIPANTS WHO HAD CHOSEN TO RAISE ALL OR PART OF THEIR CONTRIBUTION IN THIS WAY.

19. ANOTHER QUESTION WITH A SCHEME OF THIS KIND WOULD BE HOW TO ENSURE THAT THE RECOURSE TO MULTILATERAL GUARANTEES DID NOT REDUCE THE USEABLE SIZE OF COUNTRIES' QUOTAS BECAUSE OF THE NEED TO PROVIDE MORE THAN 100 PERCENT COVER TO MEET THE EVENTUALITY OF DEFAULT BY A GUARANTOR. ONE METHOD WOULD BE TO AUTOMATICALLY INCREASE A COUNTRY'S CONTINGENT LIABILITIES BEYOND ITS QUOTA BY A FRACTION OR MULTIPLE OF THE AMOUNT OF ITS CONTRIBUTIONS THAT HAD BEEN MET BY BORROWING BY THE FACILITY.

C. DIRECT CONTRIBUTIONS AND/OR CONTRIBUTIONS PREFINANCED BY THE B.I.S. AND/OR BORROWING BY THE FACILITY BACKED BY THE GUARANTEE OF ALL PARTICIPANTS.

20. WITH THIS SCHEME IT MIGHT BE USEFUL TO DISTINGUISH TWO VARIANTS:

(A) WITH A CLAUSE REQUIRING ALL PARTICIPANTS IN A LOAN OPERATION TO PROVIDE SOME MINIMUM FRACTION OF THEIR CONTRIBUTION (SAY 25 OR 50 PERCENT) IN THE FORM OF DIRECT CONTRIBUTIONS OR CONTRIBUTIONS PREFINANCED BY THE B.I.S.

(B) WITHOUT SUCH A CLAUSE.

21. THE INCLUSION OF A CLAUSE OF THE TYPE ENVISAGED IN C-A MIGHT BE REGARDED AS NECESSARY BY THOSE PARTICIPANTS WHO EXPECT TO BE MAKING ONLY DIRECT CONTRIBUTIONS, AS A COUNTERPART TO THEIR AGREEMENT TO ACCEPT CONTINGENT LIABILITIES WITH RESPECT TO THE GUARANTEES USED TO BACK BORROWING BY THE FACILITY. SUCH A CLAUSE MIGHT ALSO BE REGARDED AS DESIRABLE ON MORE GENERAL GROUNDS, SINCE, WITH ALL COUNTRIES BOTH PROVIDING SOME FUNDS AND PARTICIPATING IN THE GUARANTEE, THIS WOULD PROVIDE A STRONGER ELEMENT OF LIQUIDITY FOR THE SCHEME AND UNDERLINE THE PRINCIPLE OF MUTUAL SOLIDARITY IT IS DESIGNED TO REINFORCE.

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22. WITH A SCHEME OF THIS KIND THERE WOULD BE A NUMBER OF QUITE DIFFICULT TECHNICAL PROBLEMS. FIRST, AS DISCUSSED ABOVE IN PARAGRAPH 19, IT WOULD BE NECESSARY TO ENSURE THAT RESORT TO THE BORROWING OPTION DID NOT REDUCE THE EFFECTIVE OVERALL SIZE OF THE FACILITIES BECAUSE OF THE NEED TO PROVIDE ADDITIONAL COVER FOR POSSIBLE DEFAULT BY A GUARANTOR. SECOND, THERE WOULD BE THE QUESTION OF HOW TO BRING INTO THE MULTILATERAL GUARANTEE SOME DEGREE OF BACKING FROM THE COUNTRIES WHO HAD FULLY PAID UP THEIR CONTRIBUTIONS AND WHETHER THIS WOULD OR WOULD NOT INCREASE THESE COUNTRIES CONTINGENT LIABILITIES BEYOND THEIR QUOTA LIMITS. SOME MEMBERS OF THE GROUP POINTED OUT THAT ONE COULD ENVISAGE ARRANGEMENTS WHEREBY BORROWING BY THE FACILITY WAS BACKED IN THE LAST RESORT BY THE UNUSED QUOTAS OF ALL PARTICIPANTS. THIS WOULD PROVIDE SOME ADDITIONAL COVER-INITIALLY SUBSTANTIAL-FROM FULLY "PAID UP" PARTICIPANTS, WHICH WOULD NOWEVER DISAPPEAR IF AND WHEN LOANS GRANTED REACHED THE UPPER LIMIT OF ONE HALF OF TOTAL QUOTAS.

23. IT SHOULD BE NOTED THAT WITH ANY OF THE ABOVE SCHEMES IT MIGHT BE USEFUL TO ADD ONE FURTHER ELEMENT OF FLEXIBILITY ALONG THE LINES SUGGESTED BY ONE MEMBER OF THE GROUP, WHEREBY THE FACILITY SHOULD BE PERMITTED TO BORROW FROM A PARTICIPANT, ON A VOLUNTARY BASIS, AMOUNTS ADDITIONAL TO ITS CONTRIBUTION TO OUTSTANDING OR IMPENDING LOANS. THIS METHOD OF FINANCING COULD BE USEFUL IN CONDITIONS WHERE IT SEEMED DIFFICULT OR UNNECESSARILY CUMBERSOME TO RECYCLE FUNDS AWAY FROM ONE OR TWO PARTICULARLY STRONG COUNTRIES THROUGH BORROWING IN THEIR MARKETS.

4. OPTING OUT IN A MIXED SYSTEM

24. THE GROUP'S DISCUSSION SHOWED HOW CLOSELY THE QUESTION OF OPTING OUT IS DEPENDENT ON THE TYPE OF SYSTEM ENVISAGED. IN THE LIGHT OF THE VIEWS EXPRESSED IT MAY BE USEFUL TO MAKE THE FOLLOWING COMMENTS ON THE ALTERNATIVE SCHEMES DISCUSSED ABOVE:

(A) IT APPEARED TO BE AGREED THAT THERE COULD BE

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NO OPTING OUT OF THE ULTIMATE CREDIT RISK (PARA 14).

(B) THERE WOULD SEEM TO BE LITTLE OR NO NEED FOR ARRANGEMENTS FOR OPTING OUT WITH SYSTEMS OF TYPE B OR

C ((B) ABOVE, SINCE THERE WOULD BE NO REQUIREMENT TO PROVIDE CASH, BUT ONLY TO PARTICIPATE IN THE GUARANTEE BACKING BORROWING BY THE FACILITY.

(C) THE CASE FOR AN OPTING OUT CLAUSE WOULD BE SOMEWHAT STRONGER WITH A SYSTEM OF TYPE C-A, BUT THE LESS SO THE SMALLER THE FRACTION OF PAID IN CONTRIBUTION REUIRED.

(D) THE CASE FOR OPTING OUT WOULD APPEAR TO BE STRONGEST WITH A SYSTEM OF TYPE A, ALTHOUGH COUNTRIES NOT WISHING TO DRAW ON THEIR RESERVES WOULD STILL HAVE THE OPTION OF OBTAINING FINANCE THROUGH THE B.I.S.

5. CURRENCY DENOMINATION AND INTEREST RATES IN A MIXED SYSTEM

25. THE U.S. PROPOSED THAT BOTH LENDING TO AND BORROWING FROM THE FACILITY MIGHT BE DENOMINATED IN S.D.R.'S AND THAT INTEREST RATES WOULD BE BASED ON RATES PREVAILING IN INTERNATIONAL CAPITAL MARKETS. THE DISCUSSION (AND THE NOTE PRODUCED BY THE SECRETARIAT) SHOWED HOW CLLSELY THE QUESTION OF DENOMINATION AND INEEREST RATE ARE RELATED BOTH TO EACH OTHER AND TO THE TPE OF SCHEME ENVSAGED. IT ALSO BECAME APPARANT THAT IN ANY MIXED SYSTEM, THE BEST WAY TO MINIMIZE PROBLEMS RELATED TO EXCHANGE RISK AND INTEREST RATE SUBSIDIES WOULD BE TO KEEP THE DENOMINATION AND THE INTEREST RATE ON ALL THE FACILITY'S OPERATIONS AS CLOSE AS POSSIBLE TO THE TERMS ON WHICH FUNDS WERE BEING OBTAINED THROUGH THE B.I.S. OR FROM THE MARKET. THE CASE FOR CHARGING BORROWERS SOMETHING LIKE THE RATE AT WICH A "GOOD NAME" CAN OBTAIN USEFUL CURRENCIES ON THE PRIVATE MARKET CAN ALSO BE JUSTIFIED AS BEING CONSISTENT WITH THE CONCEPT OF THE FACILITY AS A SAFETY NET OF LAST RESORT.

26. DISCUSSIONS FOLLOWING THE FIRST MEETING APPEAR TO SUGGEST THAT WITH A MIXED SYSTEM OF TYPE A THERE WOULD BE A GOOD CASE FOR DENOMINATING

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TRANSACTIONS IN DOLLARS, CHARGING BORROWERS THE RATE AT WHICH THE B.I.S. WAS ABLE TO MAKE FUNDS AVAILABLE TO PARTICIPANTS FINANCING THEIR CONTRIBUTIONS THROUGH THE B.I.S., AD PROBABLY ALSO PAYING THE SAME RATE TO COUNTRIES MAKING DIRECT CONTRIBITIONS. UNLESS THE B.I.S. WERE ABLE TO OBTAIN SUFFICIENT LONGR TERM FUNDS THIS UNIFORM RATE WOULD HAVE T BE ADJUSTED PERIODICALLY.

27. IN MIXED SYSTEMS OF TYPE B OR C THERE WOULD

BE ADDITIONAL PROBLEMS IN SO FAR AS THE FACILITY'S BORROWING FROM THE MARKET WAS AT DIFFERENT INTEREST RATES THAN THOSE CURRENTLY BEING CHARGED BY THE B.I.S. TO COUNTRIES MAKING USE OF THE PREFINANCING OPTION. AS POINTED OUT AT TH MEETING THERE WOULD BE THREE POSSIBILITES: TO CHANGE BORROWERS,
(A) AN AVERAGE RATE (APPARENTLY FAVORED BY SEVERAL MEMBERS),

(B) THE HIGHER RATE, WITH THE BENEFIT GOING TO THOSE COUNTRIES WHO HAD MADE CONTRIBU- TIONS DIRECTLY OR THROUGH THE B.I.S., OR

(C) THE LOWER RATE, WITH THE COST BEING BORNE BY THOSE COUNTRIES WHICH HAD NOT PAID UP THEIR CONTRIBUTIONS.

6. TRANSFERABILITY AND/OR LIQUIDITY OF CLAIMS
ON THE FACILITY

28. SEVERAL MEMBERS OF THE GROUP AGREED WITH THE SUGGESTION THAT CLAIMS ARISING FROM DIRECT CONTRIBUTIONS TO THE FACILITY SHOULD BE VOLUNTARILY TRANSFERABLE AMONG PARTICIPANTS WITH APPROVAL FROM THE MANAGING BOARD. IN ADDITION, IT SHOULD BE NOTED THAT THESE CLAIMS WOULD ACQUIRE SOME DEGREE OF LIQUIDITY IF A COUNTRY HAVING INITIALLY MADE A DIRECT CONTRIBUTION WERE PERMITTED TO REFINANCE IT THROUGH THE B.I.S. IN CASE OF NEED.

7. BORROWING LIMITS
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29. SEVERAL MEMBERS OF THE GROUP AGREED THAT THE UPPER LIMIT TO BORROWING BY ANY INDIVIDUAL COUNTRY SHOULD BE THE AMOUNT OF ITS QUOTA PLUS THE AMOUNT OUTSTANDING OF ANY CREDITS IT HAD EXTENDED TO THE FACILITY. SEVERAL FELT, HOWEVER, THAT THE MANAGING BOARD SHOULD HAVE THE POWER TO EXCEED THIS LIMIT ON THE BASIS OF AN APPROPRIATE WEIGHTED MAJORITY. ONE OR TWO MEMBERS FELT THAT THE NORMAL BORROWING LIMIT MIGHT BE SET AT SOME MULTIPLE OF EACH COUNTRY'S QUOTA.

PART II - OTHER QUESTIONS

1. AIMS

30. IT APPEARED TO BE AGREED THAT THE PURPOSE OF THE AGREEMENT WOULD BE TO ACT AS A "SAFETY NET",

SUPPLEMENTING PRIVATE AND MULTILATERAL CREDITS, TO PROVIDE FINANCIAL ASSISTANCE TO PARTICIPANTS ENCOUNTERING SERIOUS ECONOMIC DIFFICULTIES. IT WAS FURTHER AGREED THAT A MAJOR AIM OF THE SCHEME WOULD BE TO ENCOURAGE AND ENABLE PARTICIPANTS TO FOLLOW APPROPRIATE ECONOMIC POLICIES AND MAINTAIN AN OPEN TRADE AND PAYMENTS SYSTEM.

31. MOST MEMBERS OF THE GROUP SEEMED TO FEEL IT WOULD BE LOGICAL TO HAVE SOME LINK BETWEEN PARTICIPATION IN THE ARRANGEMENTS FOR SUPPLEMENTARY FINANCIAL ASSISTANCE AND COOPERATIVE POLICIES TO REDUCE DEPENDENCE ON OIL IMPORTS. SOME MEMBERS WOULD, HOWEVER, PREFER NOT TO SEE THIS STATED AS AN AIM OF THE SCHEME, ALTHOUGH THEY COULD ACCEPT A REFERENCE TO COOPERATIVE ENERGY POLICIES AS A FACTOR TO BE TAKEN INTO ACCOUNT IN DETERMINING ELIGIBILITY FOR FINANCIAL ASSISTANCE. OTHERS FELT THAT AN EXPLICIT REFERENCE TO THE AIM OF REDUCING DEPENDENCE ON OIL IMPORTS WOULD BE NECESSARY IN ORDER TO OBTAIN LEGISLATIVE APPROVAL FOR THE SCHEME.

32. SOME ALTERNATIVE DRAFTING SUGGESTIONS ARE SET OUT IN THE ANNEX.

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33. THE UNITED STATES MEMBER OF THE GROUP SUGGESTED THAT, IN ADDITION TO SPECIFYING ITS AIMS AND CONDITIONS FOR ELIGIBILITY TO CREDIT, THE AGREEMENT SHOULD SET OUT CERTAIN "GOVERNING PRINCIPLES" WHICH PARTICIPANTS WOULD UNDERTAKE TO FOLLOW. IT WOULD BE USEFUL TO HAVE THE REACTION OF OTHER MEMBERS TO THIS SUGGESTION.

2. PARTICIPATION AND QUOTAS

34. IT WAS AGREED THAT PARTICIPATION IN THE SCHEME WOULD BE OPEN TO ALL THE MEMBER COUNTRIES OF THE OECD PREPARED TO ACCEPT THE OBLIGATIONS SET OUT IN THE AGREEMENT.

35. IT WAS AGREED THAT IT WOULD BE BEST TO HAVE A SINGLE "KEY" OR DISTRIBUTION OF QUOTAS, TO BE USED AS THE BASIS FOR DETERMINING THE MAXIMUM AMOUNT THAT A PARTICIPANT COULD BORROW FROM THE FACILITY, HIS OBLIGATION TO MAKE FUNDS AVAILABLE TO THE FACILITY OR TO PROVIDE BACKING FOR BORROWING BY THE FACILITY, AND FOR VOTING PURPOSES IF IT IS DECIDED TO HAVE A SYSTEM OF WEIGHTED MAJORITY VOTING. IN VIEW OF THIS, IT ALSO APPEARED TO BE AGREED THAT SHARES OF PARTICIPA-

TION IN THE AGREEMENT, OR QUOTAS, SHOULD BE RELATED TO VARIOUS ECONOMIC FACTORS RELEVANT TO BOTH POTENTIAL NEED FOR FINANCIAL SUPPORT AND POTENTIAL ABILITY TO PROVIDE SUPPORT. IT WAS NOTED THAT IF IT WERE POSSIBLE TO DERIVE A FORMULA FOR DETERMINING QUOTAS THIS WOULD FACILITATE THE ENTRY OF NEW MEMBERS AFTER THE INITIAL SETTING UP OF THE SCHEME. IN VIEW OF THE ESSENTIALLY TEMPORARY NATURE OF THE SCHEME IT WOULD NOT APPEAR NECESSARY TO LAY DOWN ANY SPECIFIC PROCEDURE FOR THE ALTERNATION OR REVISION OF QUOTAS.

36. THE GROUP TOOK NOTE OF AN ILLUSTRATIVE SCHEDULE OF QUOTAS PUT FORWARD BY THE U.S. MEMBER, AND AN ALTERNATIVE SCHEDULE PRESENTED BY THE BELGIAN MEMBER WHICH GIVES A MORE NEARLY EQUAL WEIGHT TO THE UNITED STATES AS TO THE EEC. MEMBERS MAY WISH TO STUDY FURTHER THE SUGGESTIONS MADE SO FAR AND CONSIDER CONFIDENTIAL

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WHETHER THEY WOULD LIKE TO PROPOSE FURTHER ALTERNATIVES. INDEED IT WOULD BE HELPFUL IF THE GROUP'S REPORT SET OUT ONE OR MORE QUOTA SCHEDULES FOR ILLUSTRATIVE PURPOSES.

3. INSTITUTIONAL ARRANGEMENTS AND DECISION-MAKING

37. MANY MEMBERS OF THE GROUP APPEARED TO BE IN FAVOR OF A TWO-TIER INSTITUTIONAL ARRANGEMENT ALONG ROUGHLY THE FOLLOWING LINES:

(A) A GOVERNING COMMITTEE SHOULD BE ESTABLISHED IN THE OECD. IT WOULD CONSIST OF SENIOR FINANCIAL OFFICIALS APPOINTED BY GOVERNMENTS, AND ON WHICH ALL PARTICIPANTS WOULD BE REPRESENTED. DECISIONS OF THIS COMMITTEE WOULD BE MADE BY WEIGHTED VOTING OF PARTICIPANTS, WITH VOTES WEIGHTED ON THE BASIS OF THEIR QUOTAS.

(B) THERE SHOULD ALSO BE A SMALL MANAGING BOARD, THE MEMBERS OF WHICH WOULD BE APPOINTED BY GOVERNMENTS. THIS BOARD WOULD CONSIDER APPLICATIONS FOR LOANS, RECOMMEND CONDITIONS AND TERMS, ESTABLISH THE MEANS OF FINANCING AND MAINTAIN CONTACT WITH B.I.S. THE BOARD WOULD MAKE RECOMMENDATIONS TO THE GOVERNING COMMITTEE ON ALL FINANCIAL MATTERS UNDER THE AGREEMENT AND WOULD DECIDE ON ITS RECOMMENDATIONS BY A SIMPLE MAJORITY OF ITS MEMBERS.

38. ONE MEMBER OF THE GROUP WONDERED WHETHER IT

MIGHT NOT BE POSSIBLE TO USE EXISTING COMMITTEE OF THE OECD FOR THE MANAGEMENT OF THE SCHEME AND MAINTAIN THE USUAL RULE OF UNANIMITY. ONE OR TWO OTHER MEMBERS RESERVED THEIR POSITION ON THE QUESTION OF WEIGHTED VOTING. ONE OR TWO ALSO FELT THAT MEMBERS OF THE MANAGING BOARD SHOULD BE APPOINTED IN THEIR CAPACITY AS EXPERTS RATHER THAN AS GOVERNMENT OR CENTRAL BANK REPRESENTATIVES.

39. IT WAS SUGGESTED THAT IN PREPARING ITS
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RECOMMENDATIONS, THE MANAGING BOARD WOULD NOT NORMALLY REQUIRE FORMAL OPINIONS FROM OTHER BODIES. IT WOULD BE UP TO THE MANAGING BOARD TO JUDGE, ON THE BASIS OF ITS KNOWLEDGE OF THE WORK OF OTHER BODIES OF THE OECD AND OUTSIDE THE OECD, WHETHER THE BORROWER WAS FOLLOWING SATISFACTORY POLICIES IN THE SECTOR CONCERNED. IN ORDER TO AVOID UNNECESSARY DUPLICATION, MEETINGS OF THE BOARD SHOULD BE ATTENDED BY REPRESENTATIVES OF THE MANAGING DIRECTOR OF THE IMF AND THE COMMISSION OF THE EEC SO AS TO INFORM AND TO BE KEPT INFORMED OF THESE INSTITUTIONS ACTION IN RELATION TO THE COUNTRY CONCERNED. THE B.I.S. WOULD ALSO BE REPRESENTED ON THE BOARD.

40. UNLESS IT IS DECIDED TO REQUIRE UNANIMITY, IT WILL BE NECESSARY TO DECIDE ON THE MAJORITY (WEIGHTED OR UNWEIGHTED) REQUIRED FOR VARIOUS TYPES OF DECISION. THE U.S. MEMBER HAS MADE SOME SUGGESTIONS IN THIS RESPECT. IT WOULD BE USEFUL TO TRY TO REACH AGREEMENT ON WHICH OF THE IMPORTANT DECISIONS SHOULD OR SHOULD NOT REQUIRE A SPECIAL MAJORITY. A TENTATIVE LIST MIGHT BE AS FOLLOWS:

ENTRY INTO FORCE

OPERATING DECISIONS

-- GRANTING A LOAN

-- OPTING OUT OF DIRECT CONTRIBUTION

-- EXCEEDING THE NORMAL BORROWING LIMIT

PROLONGATION OR TERMINATION

-- INCREASE OF RESOURCES OR ADMISSION OF
ADDITIONAL MEMBERS

-- PROLONGATION AFTER INITIAL PERIOD OR
TERMINATION OF NEW LENDING

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-- WINDING UP

AMENDMENT

4. CONDITIONS FOR BORROWING

41. IT WAS AGREED THAT IT WOULD BE IMPRACTICABLE AND UNDESIRABLE TO LAY DOWN CONDITIONS GOVERNING ELIGIBILITY FOR BORROWING FROM THE FACILITY IN ADVANCE IN ANY DETAIL. THE MANAGING BOARD WOULD BE EXPECTED TO BASE ITS DECISIONS ON CERTAIN BROAD PRINCIPLES CONCERNING APPROPRIATE GENERAL ECONOMIC POLICIES, THE AVOIDANCE OF DISRUPTIVE BALANCE OF PAYMENTS ADJUSTMENT POLICIES, COOPERATIVE ENERGY POLICIES AND APPROPRIATE USE OF ALTERNATIVE SOURCES OF FINANCE. A TENTATIVE FORM OF WORDS IS GIVEN IN THE ANNEX.

42. IT MAY BE USEFUL TO NOTE TWO POINTS. FIRST, IT APPEARED TO BE AGREED THAT APPLICANTS SHOULD HAVE MADE "APPROPRIATE USE" -- BUT NOT NECESSARILY TO HAVE EXHAUSTED -- ALTERNATIVE MULTILATERAL FINANCING ARRANGEMENTS, IN PARTICULAR THROUGH THE IMF. SECOND, IT APPEARED TO BE AGREED THAT APPLICANTS WOULD BE EXPECTED TO REFRAIN FROM UNDESIRABLE FORMS OF COMPETITION FOR FUNDS.

5. SIZE OF THE SCHEME

43. MANY MEMBERS OF THE GROUP FELT THAT THE SIZE OF THE SCHEME SHOULD NOT BE CONSIDERED IN TERMS OF COVERING A CERTAIN FRACTION OF THE SURPLUSES OF THE OIL-PRODUCING COUNTRIES BUT RATHER WITH REGARD TO ITS CAPACITY TO PROVIDE ADEQUATE SUPPLEMENTARY ASSISTANCE TO POTENTIAL BORROWERS IN ITS FUNCTION AS A "SAFETY NET". SOME MEMBERS OF THE GROUP APPEARED TO FEEL THAT THE FIGURES SUGGESTED IN THE NOTE BY THE U.S. MEMBER WERE OF THE RIGHT GENERAL ORDER OF MAGNITUDE. SOME FELT THAT THE SIZE OF THE SCHEME SHOULD DEPEND ESSENTIALLY ON THE DECISIONS TAKEN ON THE 1975 OIL FACILITY IN THE IMF AND THAT THE FIGURES SUGGESTED BY THE UNITED STATES WERE TOO HIGH. OTHERS FELT THAT

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IF, AS SUGGESTED, THERE WERE A RIGID UPPER LIMIT ON THE AMOUNT AN INDIVIDUAL PARTICIPANT COULD BORROW THE FIGURES MIGHT BE TOO LOW.

44. IT WAS NOTED THAT IF BORROWING LIMITS ARE SET EQUAL TO LENDING LIMITS QUOTAS TOTALING \$25 BILLION WOULD ALLOW A MAXIMUM OF \$12.5 BILLION OF CREDITS. IT WAS ALSO POINTED OUT THAT IN A MIXED SCHEME WITH SUBSTANTIAL AMOUNTS OF BORROWING BACKED BY MULTILATERAL GUARANTEES, THE EFFECTIVE SIZE OF THE SCHEME COULD BE FURTHER REDUCED TO PERHAPS ONLY A QUARTER OF THE TOTAL OF QUOTAS BECAUSE OF THE NEED TO PROVIDE MORE THAN 100 PERCENT COVER.

6. MATURITY OF LOANS AND DURATION OF THE SCHEME

45. THERE WAS A WIDESPREAD AGREEMENT THAT LOANS BY THE FACILITY SHOULD PROBABLY BE FOR A PERIOD OF 5 TO 7 YEARS. ANOTHER POSSIBILITY, SUGGESTED BY ONE OR TWO MEMBERS, PROVIDES THAT THE LOANS SHOULD HAVE AN INITIAL PERIOD OF 3 YEARS, WITH THE POSSIBILITY OF TWO EXTENSION FOR TWO YEARS ON INCREASINGLY TOUGH TERMS.

7. IT WAS WIDELY AGREED THAT IF THE SCHEME WERE SET UP AT ALL IT WOULD BE LIKELY TO BE NEEDED FOR A PERIOD OF AT LEAST TWO OR THREE YEARS. ON THE OTHER HAND, IT ALSO APPEARED TO BE AGREED THAT IN ORDER TO UNDERLINE THE ESSENTIALLY TEMPORARY NATURE OF THE SCHEME, THE POWER TO GRANT NEW LOANS MIGHT LAPSE AFTER A FIXED PERIOD UNLESS RENEWED BY A FAIRLY HIGH WEIGHTED MAJORITY. IT WAS SUGGESTED THAT IT MIGHT BE USEFUL TO FIX IN ADVANCE THE RESOURCES POTENTIALLY AVAILABLE TO THE FACILITY FOR THE WHOLE OF THE INITIAL PERIOD OF 2 OR THREE YEARS. IT WAS POINTED OUT, HOWEVER, THAT THIS WOULD BE DIFFICULT FOR COUNTRIES WHOSE LEGISLATURES WERE RELUCTANT TO AUTHORIZE FINANCIAL COMMITMENTS FOR MORE THAN ONE YEAR AHEAD. (THE CHAIRMAN WOULD WELCOME SUGGESTIONS AS TO HOW BEST TO DEAL WITH THESE DIFFERENT CONSIDERATIONS.) ONE MEMBER SUGGESTED THAT THE FACILITY'S RESOURCES SHOULD BE LOWER IN EACH SUCCESSIVE YEAR.
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ANNEX - DRAFTING SUGGESTIONS FOR VARIOUS ASPECTS OF THE SCHEME

AIMS

1. TO ACT AS A "SAFETY NET", SUPPLEMENTING

PRIVATE CREDIT AND PUBLIC MULTINATERAL FACILITIES,
TO OECD COUNTRIES ENCOUNTERING SERIOUS ECONOMIC
DIFFICULTIES.

2. TO ENCOURAGE AND ENABLE PARTICIPANTS TO
FOLLOW APPROPRIATE DOMESTIC ECONOMIC POLICIES.

3. TO HELP MAINTAIN OPEN TRADE AND PAYMENTS
SYSTEM.

4. (TO HELP MEMBER COUNTRIES TO REDUCE THEIR
DEPENDENCE ON OIL IMPORTS)
(TO ENCOURAGE MEMBER COUNTRIES TO FOLLOW
COOPERATIVE ENERGY POLICIES)
(TO SUPPORT EFFORTS MADE BY THE OECD
COUNTRIES TO DEAL WITH THE BALANCE OF PAYMENTS
PROBLEMS RESULTING FROM THE RISE IN OIL PRICES)

ACCESS TO CREDIT FROM THE SOLIDARITY FUND

EACH REQUEST FOR CREDIT FROM THE FACILITY WOULD
BE CONSIDERED PROMPTLY BY THE MANAGING BOARD. THE
MANAGING BOARD SHOULD SATISFY ITSELF, IN THE LIGHT
OF INFORMATION SUBMITTED BY THE APPLICANT AND AN
ASSESSMENT BY THE SECRETARIAT, THAT:

A. THE APPLICANT WAS IN NEED OF FINANCIAL
ASSISTANCE AND WAS FOLLOWING APPROPRIATE
ECONOMIC POLICIES, BOTH DOMESTIC AND INTERNATIONAL.

B. THE APPLICANT WAS NOT IMPOSING, WITHOUT
APPROPRIATE INTERNATIONAL APPROVAL, TRADE OR OTHER
CURRENT ACCOUNT MEASURES FOR BALANCE OF PAYMENTS
PURPOSES.

C. THE APPLICANT WAS FOLLOWING COOPERATIVE
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ENERGY POLICIES.

D. THE APPLICANT WAS MAKING REASONABLE USE OF
ITS RESERVES AND WAS MAKING BEST EFFORTS TO OBTAIN
CAPITAL ON REASONABLE TERMS FROM OTHER SOURCES, PUBLIC
AND PRIVATE, WHILE REFRAINING FROM UNDESIRABLE
FORMS OF COMPETITION FOR FUNDS. A PARTICIPANT
WOULD BE EXPECTED TO MAKE APPROPRIATE USE OF CREDIT
FACILITIES AVAILABLE THROUGH THE IMF AND THE EEC.

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